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In The

Supreme Court of the United States

October Term, 1967

No. 1182

Texaco Inc., Sunray DX Oil Company, Humble Oil & Refining Company, Union Producing Company, Edwin L. Cox, Sohio Petroleum Company, Gulf Oil Corporation and Lamar Hunt,

Petitioners,

v.

Federal Power Commission, The United Gas Improvement Company, The Brooklyn Union Gas Company, Philadelphia Electric Company, Long Island Lighting Company, and Public Service Commission of The State of New York,

Respondents.

CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. .....

TEXACO INC., SUNRAY DX OIL COMPANY, HUMBLE OIL & REFINING COMPANY, UNION PRODUCING COMPANY, EDWIN L. COX, SOHIO PETROLEUM COMPANY, GULF OIL CORPORATION AND LAMAR HUNT,
Petitioners,

v.

FEDERAL POWER COMMISSION, THE UNITED GAS IMPROVEMENT COMPANY, THE BROOKLYN UNION GAS COMPANY, PHILADELPHIA ELECTRIC COMPANY, LONG ISLAND LIGHTING COMPANY, AND PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Respondents.

CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioners, Texaco Inc., Sunray DX Oil Company, Humble Oil & Refining Company, Union Producing Company, Edwin L. Cox, Sohio Petroleum Company, Gulf Oil Corporation, and Lamar Hunt (producers) petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit entered in this case on December 9, 1966, the writ to issue, however, only in the event that this Court grants the Petitioners for Writ of

Certiorari with respect to Question No. 2 in No. 1134 and Question No. 1 in No. 1135, this Term.[1]

Opinions Below

The majority and dissenting opinions of the Court of Appeals is reported at 370 F. 2d 181 and is reprinted as Appendix A to the Petition filed by The United Gas Improvement Company in No. 1134. The opinion and order of the Federal Power Commission (Commission) is reported at 31 F.P.C. 623 and its opinion on rehearing at 31 F.P.C. 1315.

Jurisdiction

The jurisdictional requisites are adequately set forth in the Petitions in Nos. 1134 and 1135.

Question Presented

If the court below erred in approving the Commission's consideration, *inter alia,* of temporary certificates and its *Policy Statement* guideline price levels[2] in determining the initial price at which these producers' sales would be permanently certificated (as contended by distributors in Nos. 1134 and 1135), did the court thereby also err in its inter-related holding affirming the Commission's exclusion of certain industry economic and cost-trend evidence proffered by producers.

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[1] This cross-petition does not directly challenge the decision of the court below on its inter-related holdings (1) affirming the Commission's in-line price determination, and (2) affirming the Commission's exclusion of evidence offered by producers. If this Court grants certiorari in Nos. 1134 and 1135 and reverses the lower court on (1) above, then we contend its inter-related holding on point (2) above would become erroneous and should be reversed.

[2] *Statement of General Policy No. 61-1,* 24 F.P.C. 818 (1960). *Fifth Amendment to Statement of General Policy No. 61-1,* 28 F.P.C. 441 (1962).

Statute and Regulations Involved

The pertinent provisions of the Natural Gas Act, 52 Stat. 823-833, as amended, 15 U.S.C. §§ 717-717w, are set forth in the petitions in Nos. 1134 and 1135. The pertinent provisions of the Commission's *Statement of General Policy No. 61-1*, 18 CFR 2.56(a), 24 F.P.C. 818 (1960) (*Policy Statement*), and *Fifth Amendment to Statement of General Policy No. 61-1*, 28 F.P.C. 441 (1962) (*Fifth Amendment*), are reprinted in our Brief in Opposition in Nos. 1133, 1134, and 1135, this Term.

Statement[3]

In its order consolidating these applications for certificates of public convenience and necessity for hearing, the Commission provided that:

> "In such a hearing all of the applicants will have an opportunity to show whether the appropriate price at which they should be permanently certificated should be limited to the 15 cent per Mcf price which we found to be the in-line price as of September 28, 1960, the 16 cent per Mcf price which is being adopted as the future area ceiling price for this area, or the 18 cent per Mcf price established on September 28, 1960." (J.A. 199)

In response to the foregoing directive of the Commission, producers prepared evidence directly bearing on the factors specifically enumerated by the Commission in both its *Policy Statement* and the *Fifth Amendment* thereto as being relevant and material in determining the appropriate

[3] In this Statement, we refer only to those facts and parts of the Opinion below relevant to the Court of Appeals' affirmance of the Commission's exclusion of the evidence proffered by producers. For a fuller treatment of the facts and proceedings, see our Brief in Opposition in Nos. 1133, 1134, and 1135, this Term.

initial price level.[4] Although this evidence was also specifically directed to the statutory standard of public convenience and necessity established by Section 7 of the Natural Gas Act, it was completely excluded by the Commission.

The producers' jointly sponsored evidence consumed less than 400 pages, including exhibits, and did not include individual company cost-of-service studies. It consisted of the testimony and exhibits of only five witnesses which established, *inter alia,* that (1) exploratory and drilling costs had substantially increased in the few years prior to the execution of the contract prices here in dispute (J.A. 77-85; R. 1286-1291); (2) the public interest required further exploratory and drilling efforts in this area due to increased demand and a lessening in supply (J.A. 43-45; 97-98; R. 1173-1175); (3) rapid local industrial growth created an effective alternative market for new supplies of gas found in this area (J.A. 98-99); and (4) industry average current costs of finding and producing new gas supplies exceeded the initial prices proposed by producers (J.A. 105-106).[5] All of this proffered evidence was excluded by the Commission for reasons of administrative expediency in the belief that other evidence was available in the record which would provide the Commission sufficient flexibility in result so as to permit its decision to be consistent with current conditions in the industry (J.A. 368). The Commission's reliance on such other evidence is challenged by distributors in Nos. 1134 and 1135.

The court below affirmed the Commission's ruling excluding producers' proffered evidence noting,

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[4] The Commission's statement of the evidence considered by them in establishing these price levels are set forth at pages 3 and 4 in our Brief in Opposition in Nos. 1133, 1134, 1135, this Term.

[5] The proffered evidence is summarized in more detail in the Appendix.

"We do not say that economic and geologic evidence is never admissible in a section 7 proceeding. This may depend on varying circumstances. All we say is that *in the posture of this case,* the Commission did not abuse its discretion by rejecting the evidence." (Footnote omitted; page 7a, Petition in No. 1134)[6]

Reasons for Granting the Writ

Distributor petitioners in Nos. 1134 and 1135 seek review of the issue of the appropriate initial price at which these producers' sales should be permanently certificated.[7] Our briefs in opposition to distributors' petitions fully set forth the reasons why we do not consider that issue to warrant review by this Court. If this Court should, however, decide to review the details of the in-line price methodology used by the Commission under the unique facts of the instant case, then the inter-related question raised by this cross-petition as to the propriety of the Commission's exclusion of producers' proffered evidence should also be considered.

The petitions of distributors contend it was improper for the Commission to revise its prior in-line price determination to reflect current conditions in the industry on the basis of its expertise and a consideration of, *inter alia,* its *Policy Statement* guideline price levels and temporary certificate price trends. Unless this Court affirms the Commission's procedures herein, under the exclusionary rules of evidence which distributors have successfully promulgated in producer certificate proceedings, the Commission will be unable to make whatever interim adjustments in its pricing policies are required by the public convenience and necessity during the period of almost a decade before the establishment of just and reasonable rates. The net effect of dis-

[6] All emphasis herein supplied unless otherwise indicated.

[7] This question is not presented by the Commission's Petition in No. 1133.

tributors' position challenging the evidence relied upon by the Commission is to find that the Commission must (1) abdicate to the distributors its responsibility to determine independently the appropriate initial certificate price, a responsibility entrusted to the Commission by Section 7 of the Natural Gas Act and this Court's *CATCO* decision;[8] (2) automatically fix the initial certificating price line at whatever "non-suspect" level is established by the distributors' intervention policies; (3) not consider any evidence other than permanent certificates issued at distributor-approved prices; and (4) not exercise any discretion or expertise whatsoever in its selection of the price line. The Commission, in its opinion below, succinctly stated the result which would follow if the distributors' position were adopted:

> "It is not by chance that with the single above-noted exception the only permanent certificates granted during the period were at prices of 15¢ per Mcf or lower, because all applications for higher prices were opposed by some or all of the intervenors herein. If these permanent certificates are to control, then *the 'in-line' price* for sales representing over seven times the minimal volumes of gas permanently certificated during this period *is being determined, not upon consideration of a hearing record, but by the unreviewable fiat of the intervenors.*" (J.A. 370-371)

It was impossible for the Commission in this case to make an in-line determination on the basis of the identical factors approved by this Court in *Callery*.[9] As a result of distributors' intervention policies, there were no substantial volumes of gas being sold under contemporaneously issued

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[8] *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378 (1959).

[9] *United Gas Improvement Co.* v. *Callery Properties, Inc.*, 382 U.S. 223 (1965). This Court's holding on the evidence proffered by producers in *Callery* is thus not dispositive here.

permanent certificates which could be utilized in deriving an in-line price. Therefore, *under the special facts in this case,* the Commission was faced with three possible alternatives:

> (1) Automatically accept the initial certificating level contended for by the distributors and thereby invoke a permanent price freeze of initial prices for almost a decade until just and reasonable rates are established; or
>
> (2) Consider, *inter alia,* the guideline price levels established in its *Policy Statement,* trends in temporary certificate initial price levels, and its expertise acquired in past and pending producer cases and independently determine the certificating price level required by the public convenience and necessity; or
>
> (3) Expand the scope of producer certificate proceedings to receive the industry economic and cost trend evidence proffered by producers as a basis for determining the price levels required to bring forth adequate gas supplies.

The Commission chose to follow Alternative (2) above. Although we do not believe this choice provided it with the best vehicle to follow and evaluate the rapidly changing supply and demand conditions within the industry during the substantial interim period prior to the establishment of area rates, we accept the lower court's holding that this alternative was legally available to the Commission. The court's decision was based upon the judicial respect shown to administrative expertise and an implicit recognition that Alternative (2) did provide the Commission sufficient flexibility to protect the public convenience and necessity when interim price revisions were required.

We do not feel that the Commission's exercise of regulatory discretion and expertise under the peculiar facts present in this case warrants further judicial scrutiny. However, if this Court feels constrained to review the initial price issue raised only in the distributor petitions, and thereby search out the in-line methodology which should have been used in the unique factual context of this case, it must necessarily also examine the inter-related evidentiary and procedural standards presented by Alternative (3) above.

Alternative (1) urged by distributors is clearly unlawful in that it denies the certificate applicant due process by making a mockery of the hearing required by Section 7 of the Natural Gas Act. Moreover, it places the agency in a strait jacket by foreclosing it from making an independent determination of what pricing policies are in the public convenience and necessity. Therefore, if this Court holds for distributors in Nos. 1134 and 1135 and finds Alternative (2) also to be unlawful, then it must necessarily approve Alternative (3) as requested by this cross-petition.

In this connection, reference should be made to two cases decided by the Court of Appeals for the District of Columbia Circuit which are relied upon heavily by the distributors.[10] Both cases are inapposite since there were a sufficient number of contemporaneously issued permanent certificates to permit the Commission to independently determine the in-line price under its conventional method-

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[10] *Public Service Comm'n of the State of New York* v. *Federal Power Commission*, 329 F. 2d 242 (D.C. Cir. 1964), *cert. den. sub nom Prado Oil & Gas Co.* v. *Federal Power Commission*, 377 U.S. 963 (1964) (the *Skelly* case). *Public Service Comm'n of State of New York* v. *Federal Power Commission* (D.C. Cir. Nos. 19796, February 7, 1967) (the *Sinclair-Hawkins* case; printed as Appendix C to the Petition in No. 1135).

ology. Therefore, the special evidentiary issues raised in this case were not present. Moreover, that Circuit recognized in *Skelly* that in the absence of such conventional measure of in-lineness, resort to more generalized cost and economic evidence may be required:

> "In so deciding *we need not hold that the Commission may never consider such evidence if the circumstances in a particular case move it to do so* consistently with its obligations under *CATCO*." (329 F. 2d at 247)

Alternative (3) above is also consistent with this Court's holding in *CATCO* reversing the Commission for failing to point to sufficient evidence showing "the reason why" an increase in the price line was required. (360 U.S. at 393). It is also consistent with the recent remand in the *Sinclair-Hawkins* case by the Court of Appeals for the District of Columbia Circuit resulting from the Commission's failure to state sufficient "reasons" why the price line in another area should be adjusted. The court stated:

> "But we do not hold that the FPC can never raise the price line in the interim period. We hold only that the Commission has advanced no reason why an escalation is justified in this case." (Page 31a, Petition in No. 1135)

If the position urged by distributors in Nos. 1134 and 1135 is adopted and the Commission is foreclosed from considering, *inter alia*, its *Policy Statement* guideline levels and price trends in temporary certificates in determining whether an earlier in-line price should be revised (Alternative (2)), then Alternative (3) above is the only lawful procedure. In this event, it was error for the court below to have affirmed the Commission's exclusion of the economic and cost trend evidence proffered by producers.

Otherwise, a certificate applicant would be denied fundamental due process and the right accorded by Section 7 of the Natural Gas Act to an evidentiary hearing in which to support his proposed project.

Conclusion

For the foregoing reasons, it is respectfully submitted that if the Court grants the Petitions for Writ of Certiorari on Question No. 1 in No. 1134 and on Question No. 2 in No. 1135, this Term, then it should also grant this conditional cross-petition for writ of certiorari.

Respectfully submitted,

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APPENDIX "A"

SUMMARY OF THE EVIDENCE JOINTLY SPONSORED BY THE PRODUCERS AND EXCLUDED BY THE COMMISSION

Producers in the administrative proceedings below attempted to present five witnesses and eight exhibits in order to support and justify their proposed sales of natural gas for resale in interstate commerce at the contract prices. This entire evidentiary presentation was excluded by the Commission but is contained in the Joint Appendix as an offer of proof.[1] The following is a summary of producers' joint presentation:

(1) Frith C. Owens, a consulting geologist and petroleum engineer from Corpus Christi, Texas, with over twenty years of experience specializing in the exploration for oil and gas in the Texas Railroad Commission District No. 4 presented testimony and exhibits on the prospects for further gas exploration and development in the deep sedimentary horizons or formations underlying that area. (J.A. 19-20)

After outlining the history of oil and gas exploration and development in District No. 4, (J.A. 23-25) Mr. Owens demonstrated that most of the gas from the shallower formations had been found and developed in District No. 4 (J.A. 28) but that there are deep sedimentary geological horizons or formations underlying the geographic area comprising that district which at this time are relatively unexplored. (J.A. 21-23; R. 1161) Mr. Owens' analysis of the deeper exploration accomplished in District No. 4 up to the present time

[1] The related proffered exhibits were designated as part of the Joint Appendix, but were filed separately. They are referred to herein by their Record Pagination.

resulted in the conclusion that these deep formations (below 6,000 feet) were clearly in the gas province. (J.A. 20-23; 28-30; R. 1164) Mr. Owens specified the deep formations underlying District No. 4, to which those seeking to find new supplies of natural gas would be able to direct their search. (J.A. 26-28) However, Mr. Owens concluded that a price incentive was necessary to encourage the finding and development of the deeper gas reserves located in this area, because such exploration and development requires more complex, and thus more expensive, activities to find and develop the reserves. (J.A. 31-32) Paramount in these higher costs are the drilling costs which increase significantly with greater depth. (J.A. 32)

Mr. Owens also concluded, after enumerating the activities necessary for exploration and development of new gas supplies, (J.A. 30-32) that the greater risk in locating and bringing the market the deep supplies of gas required sufficient incentive "by adequate and firm gas prices. Without this incentive in my opinion, this exploratory effort cannot be accomplished." (J.A. 33)

(2) Sherman H. Clark, a fuels economist with the Stanford Research Institute, Menlo Park, California, presented a study prepared under his direction by the Stanford Research Institute showing the estimated growth in demand for natural gas in each year during the period from 1960 through 1970. (J.A. 33-37)

Exhibit No. 6 which tabulated and recorded the results of Mr. Clark's studies and projections, contained detailed data including graphs, charts and tables showing the past and projected demand of the various areas of the country for natural gas by end use. These end uses included residential, commercial, refinery,

pipeline, other industrial steam-electric and carbon black.

On the basis of the Stanford Research Institute study, Mr. Clark concluded that the increase in demand for natural gas in the United States would increase by approximately 3.5% each year from 1960 through 1970. (R. 1165-1264) The net domestic production required to meet the demand for natural gas in 1960 was 13.3 trillion cubic feet. (J.A. 43; R. 1165-1264) Mr. Clark estimated that net domestic production would have to increase to approximately 15.9 trillion cubic feet in 1965 and 18.9 trillion cubic feet by 1970 in order to meet the increased demand for natural gas. (J.A. 44; R. 1165-1264)

(3) Radford L. Schantz, a consulting economist from Washington, D.C., presented testimony and Exhibit No. 7 directed to whether the contracts involved in this proceeding are required by the public convenience and necessity. (J.A. 68) Mr. Schantz examined comprehensive economic data contained in Exhibit No. 7 and considered trends in the exploration and development of gas supplies, productivity of the exploratory and drilling effort, cost, prices, supply and demand for gas and the available markets for the gas produced in Texas Railroad Commission District No. 4. (J.A. 69-70) Based on his analysis of these factors, Mr. Schantz concluded that supplies of natural gas had declined relative to net production and prospective demand, as estimated by Mr. Clark, so as to cause concern with respect to the adequacy of future supplies. (J.A. 97) He also concluded that rising drilling and related costs in the Texas Gulf Coast Area (including Texas Railroad District No. 4), as well as a reduction in the contract prices for sales made from that area by the Federal Power Commission had definitely impaired

incentives to find and develop the necessary supplies of natural gas. (J.A. 98) With respect to future supplies of gas, Mr. Schantz observed that a serious time lag exists between the decision to explore and the discovery of new gas supplies. Consequently, the incentive to find these new future supplies must be given today, not when a shortage occurs. (J.A. 98)

Mr. Schantz also testified that the rapid industrial growth in the Texas Gulf Coast Area has created an effective alternative market for new supplies of gas found in District No. 4 despite sales in 1960 and 1961 at 18¢ per Mcf covering approximately 38% of the gas produced in that district. (J.A. 98-99)

Exhibit No. 7 (R. 1265-1355) presented by Mr. Schantz contained, except for working papers, the data and materials on which Mr. Schantz based his conclusions and from which he gave his opinions, as well as a listing of all contracts filed with the Federal Power Commission for the sale of new supplies of gas produced in District No. 4 from 1960 through July, 1962.

Based on his analysis and these considerations, Mr. Schantz concluded that the initial contract prices proposed by producers, up to and including 18¢ per Mcf were required by the present and future public convenience and necessity. (J.A. 97)

(4) R. H. Park, Assistant Division Manager, Gas Division, Texaco Inc., Houston, Texas, presented a study on the minimum financial requirements for finding and developing new supplies of natural gas if producers are to keep supplies in pace with increased demand. (J.A. 100) Mr. Park analyzed the recent productivity of gas well drilling in the industry which in his study is the relationship between the gas reserves added and the expenditures which must be made by

producers to add those reserves. (J.A. 102-103) In Exhibit No. 8 (R. 1356-1373), Mr. Park provides the Commission with an estimate of the minimum unit cost per Mcf of marketed production required to add new reserves of natural gas based on the industry's recent aggregate experience in the producing industry.

On the basis of his study, Mr. Park concluded that in order to meet the producers' minimum financial requirements, it is necessary to have a nation-wide average price level for current resales of natural gas of approximately 23¢ per Mcf. (J.A. 105; R. 1358-1359) Mr. Park reasoned that this nation-wide average price level is necessary in order to permit producers to recover their capital expenditures, their current operating expenses, royalty payments and production taxes. (J.A. 105)

Mr. Park specifically related the use of the industry-wide financial requirements to the determination of an appropriate initial price for new sales of gas produced in Texas Railroad Commission District No. 4 and recommended that any price level for District No. 4 should not be less than 18¢ per Mcf. (J.A. 129-130)

(5) Douglas L. Henry, an engineer for Gulf Oil Corporation, Houston, Texas, presented data on the average depth of wells producing gas upon which the Commission predicated the 15¢ per Mcf "in-line" price, as compared with the deeper average depth of Gulf wells producing the gas sold to Natural Gas Pipeline Company of America from the Escobas and Martinez Fields.[2] (J.A. 138-140)

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[2] This portion of Mr. Henry's testimony concerning comparisons was admitted by the Examiner, but not considered by the Commission in reaching its decision.

Mr. Henry also compared Gulf's costs to drill and complete its shallower wells (approximately 5,000 feet) in District No. 4 with its costs to drill and complete the deeper wells (over 12,000 feet) committed to its contract and concluded that the deeper wells were 379% more expensive. (J.A. 140-141)

Utilizing industry data, Mr. Henry estimated the cost to drill and complete a well to the average depth of wells upon which the Commission predicated its 15¢ per Mcf "in-line" price (Opinion No. 362) and shows that this estimated cost was substantially less than the actual cost incurred by Gulf in drilling its deeper wells.

In addition, Mr. Henry testified that even at the contract price proposed, including all of the price escalations, the revenues generated by Gulf's sale would provide Gulf with barely a 9% return on its average investment after recovery of only the on-lease development and producing costs. (J.A. 141)